RESEARCH

SEPTEMBER 2013

MELBOURNE CBD OFFICE

Market Overview

HIGHLIGHTS

- The Melbourne CBD office vacancy rate rose to 9.8% as at July 2013 – its highest level in nine years, up from 7.0% in January 2013. Total and sublease vacancy rates have peaked for the short term and are expected to slowly trend down over the next two years. New supply has also peaked in the short term with 167,621m^2 completed in the first half of 2013 while there is only 14,235m^2 scheduled for completion over the next year.
- Similar to the other major office markets in Australia, soft tenant demand has resulted in the Melbourne CBD office market recording negative net absorption of 2,973m^2 in the first half of 2013 – the first contraction of space since July 2009. Impacted by subdued tenant demand, incentives have risen, resulting in net effective rental levels continuing to fall from early 2012.
- In stark contrast to the muted leasing activity, investment demand remains unabated. Melbourne CBD offices transacted in 2013 to date have totalled $1.32 billion, already exceeding the total value transacted in the entire 2012 year.

MELBOURNE CBD OVERVIEW

Table 1
Melbourne CBD Office Market Indicators as at July 2013

Market	Total Stock (m^2)	Vacancy Rate (%)	Annual Net Absorption (m^2)	Annual Net Additions (m^2)	Average Net Face Rent ($/$m^2$)	Average Incentive (%)	Average Core Market Yield (%)
Prime	2,740,939	9.0	84,566	216,487	425 – 500	25 – 30	6.50 – 7.25
Secondary	1,600,603	11.1	-87,539	-24,938	300 – 350	25 – 30	7.50 – 8.75
Total	4,341,542	9.8	-2,973	191,549			

Source: Knight Frank/PCA
Grade: Prime indicates Premium and A-Grade stock whilst secondary indicates B, C and D quality Grade.

SUPPLY & DEVELOPMENT ACTIVITY

In the first half of 2013, 167,621m^2 of gross office space was added to the Melbourne CBD office market, the largest half year level of supply since July 2006. This equates to 3.86% of the CBD stock, double the 20-year historical average of 1.85%.

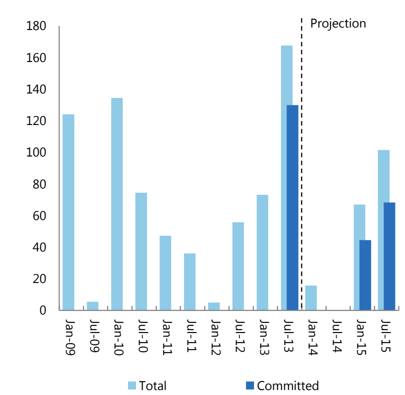
Refurbishments accounted for 20% of the 167,621m^2 that entered the market over the six months to July, predominately as a result of Australand's full refurbishment of 357 Collins Street (32,000m^2). New developments accounted for the vast majority of stock additions, led by NAB's new office at 700 Bourke Street (62,285m^2), the largest office development completed in Melbourne since ANZ's Dockland's office, completed in 2011. Other major projects completed in 2013 included Marsh Mercer's purpose built office at 1 Collins Square (38,375m^2) and 171 Collins Street (31,411m^2), the first premium grade development completed in the CBD Core since 1991.

By precinct, 60% of the new and refurbished stock added to the Melbourne CBD was located in the Docklands precinct followed by the Western Core which accounted for 19% of stock delivered in 2013 to date.

Looking forward, no major new developments are scheduled for completion until late 2014, when Westpac's new office at 150 Collins Street (20,000m^2) and Cbus Property's development for Medibank at 720 Bourke Street (47,000m^2) are delivered to the market. In contrast to the past five years, the development pipeline for the CBD for the next two years is below the historical average.

Of the 184,217m^2 that is due for completion over the next two years, 61% is currently pre-committed, leaving 71,417m^2 within the new developments for potential take-up.

Figure 1
Melbourne CBD Supply
(000's m^2) Supply (new & refurb) & commitment



Source: PCA/Knight Frank

Beyond the developments currently under construction, supply is expected to pick up in 2-3 years' time given the swell of lease expiries in the CBD in 2016 and 2017. Sites with proposals for major office developments in the Melbourne CBD seeking pre-commitments include QIC's 80 Collins Street (43,000m^2), 555 Collins Street (67,000m^2) and various schemes within Walker Corporation's Collins Square development.

New supply in the CBD is increasingly being offset with stock withdrawn; typically for residential conversion which will subsequently aid a decrease to vacancy rates. Office stock withdrawn for residential development in recent times include: 150 Queen Street (7,062m^2*), 35 Spring Street (12,805m^2*) and 464 Collins Street (1,044m^2*). Over the next two years, further withdrawals are forecast including 447 Collins Street and a number of sites with residential development proposed.

In addition to the diminished development pipeline, major backfill and sublease space also appears to have peaked for the short term. Major backfill space that has now come onto the market includes CBA's former accommodation at 385 Bourke Street and 276 Flinders Street. In 2013 to date, 75,000m^2 of backfill space has come onto the market. Over the next two years Knight Frank has identified a further 40,000m^2 of backfill and sublease space that will enter the CBD market.

* Refers NLA of office area which was withdrawn

1 150 Collins St - 20,000m² (Westpac)
GPT Wholesale Office Fund - Q3 2014 - 73% committed.

2 720 Bourke St - 47,000m² (Medibank)
Cbus Property - Q3 2014- 64% committed.

3 313 Spencer St - 27,500m² (Victoria Police)
Cbus Property/Invesco - Q1 2015 - 100% committed.

4 567 Collins St - 55,000m² (Corrs/Leighton Contractors)
Investa - Q2 2015 - 47% committed.

5 699 Bourke St - 19,000m² (AGL Energy)
Mirvac - Q2 2015 - 79% committed.

6 570 Bourke St - 27,000m²
Charter Hall - 2015+

7 685 Latrobe St - 33,000m²
Charter Hall & Flagship - 2016+

8 80 Collins St - 43,000m²
Queensland Investment Corporation (QIC) - 2016+

9 664 Collins St - 25,000m²
Mirvac - 2016+

10 2 Collins Sq - 50,000m²
Walker - 2016+

11 4 Collins Sq - 20,000m²
Walker - 2015+

12 5 Collins Sq - 35,000m²
Walker - 2016+

13 839 Collins St - 34,000m²
Lend Lease - 2016+

14 855 Collins St - 40,000m²
Lend Lease - 2016+

15 405 Bourke St - 61,000m²
Brookfield - 2016+

16 Cnr Collins & Bourke Sts - 40,000m²
Lend Lease - 2016+

17 555 Swanson St (CUB Site) - 36,000m²
Grocon - 2016+

18 Freshwater Place Stage 3 - 42,500m²
Australand - 2016+

19 360 Collins St - 34,000m²
DEXUS - 2016+

20 395 Docklands Dve - 22,000m²
MAB - 2015+

21 1000 Latrobe St - 32,500m²
Digital Harbour - 2016+

22 180 Flinders St - 20,000m²
DEXUS - 2016+

23 272 Queen St - 51,000m²
Dale-Rose P/L - 2016+

24 Harbour Tce - 60,000m²
Digital Harbour - 2016+

25 b|e South - 27,000m²
Colonial First State - 2016+

26 555 Collins St - 67,000m²
Harry Stamoulis/Grocon - 2017+

27 447 Collins St - 80,000m²
ISPT - 2017+

28 477 Collins St - 30,000m²
Aviva - 2017+

29 North Wharf - 20,000m²
WTC Asset Management - 2016+

30 601 Flinders St - 60,000m²
Eureka/Asset 1 - 2016+

31 525 Collins St - 5,000m²
St Martins/Equiset - 2016+

32 Sites 5B & 6B - 100,000m²
Lend Lease - 2016+

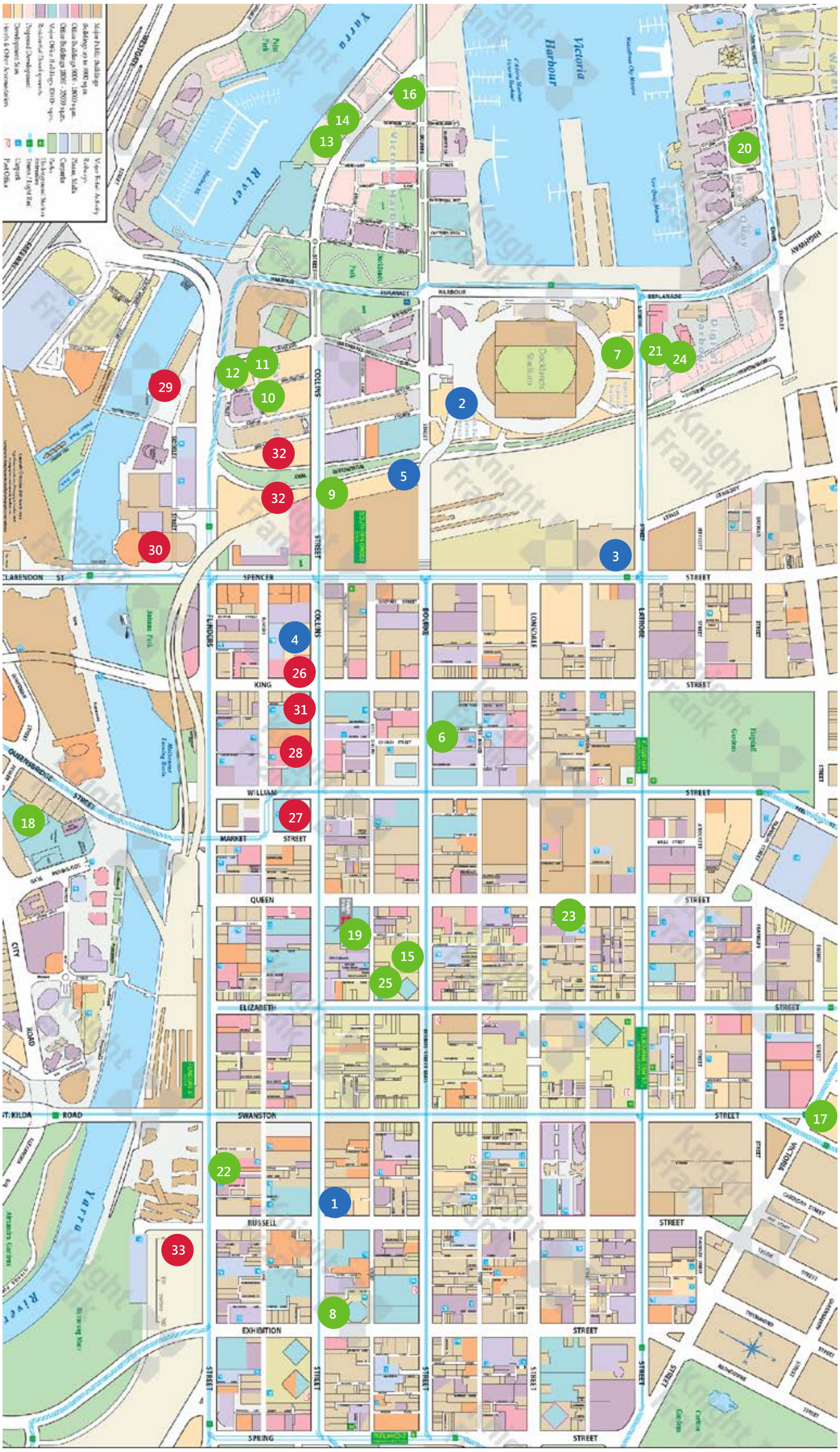
33 Fed Square East - 60,000m²
State Government - 2018+

Under Construction

DA Approved / Confirmed / Site Works

Mooted / Early Feasibility

NB. Dates are Knight Frank Research estimates
Major tenant precommitment in brackets next to NLA
Office NLA quoted



TENANT DEMAND & RENTS

The Melbourne CBD office vacancy rate rose to 9.8% as at July 2013 – its highest level since July 2004, up from 7.0% in January 2013. The level of occupied stock in the CBD declined over the first half of 2013, which was the first contraction since the first half of 2009, impacted by the soft consumer and business confidence.

Akin to the other CBD office markets of Australia, Melbourne's CBD vacancy rate is also now above its 10-year average. In terms of quality grades, vacancies rose in all grades in the six months to July 2013. Despite solid net absorption levels, prime grade office vacancies continued to rise, increasing to 9.0%. A-grade vacancy rose from 5.8% to 8.9%, largely impacted by tenant relocations to recently completed developments. Premium grade vacancy rose over the first half of 2013, predominantly as a result of new supply increasing despite occupied stock also rising. Secondary office stock also recorded a rise in vacancy, impacted by tenant relocations largely to A-grade accommodation.

Table 2
Melbourne CBD Vacancy Rates
Vacancy by building grade

Grade	Jan-13	Jul-13
Premium	6.4	9.6
A Grade	5.8	8.9
Prime	**5.9**	**9.0**
B Grade	7.5	11.1
C Grade	12.0	12.8
D Grade	2.2	2.8
Secondary	**8.7**	**11.1**
Total	**7.0**	**9.8**

Source: PCA

Sublease vacancy in the Melbourne CBD office market rose, increasing from 0.8% in January to 1.3% as at July 2013 – in line with the long term average. Sublease vacancy is forecast to have peaked with quality accommodation continuing to attract tenant interest as demonstrated by GTA Consultants and RSM Bird Cameron both taking sublease space offered by ANZ at 55 Collins Street.

By precinct, while the majority rose in the six months to July 2013, all precincts (including the Docklands) are now above their 10-year averages. The Civic precinct rose to 12.3%, its highest level since January 2000, impacted by the relocations of BHP, NAB and Commonwealth Bank. The Spencer precinct also increased, rising to 18.1% - its highest level since July 1996. Despite over 101,000 m^2 of new space added in Docklands in 2013 to date, its vacancy rate fell to 3.1%.

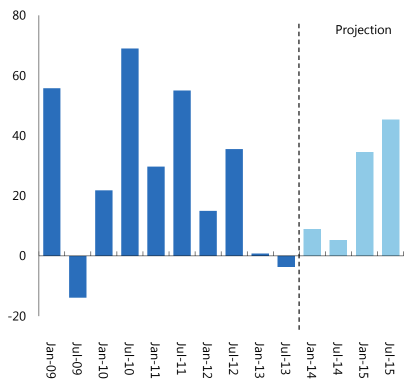
While employment across Victoria has risen only modestly since late 2010, employment is still growing, with population growth continuing to support several sectors. In the year to May 2013, employment continued to increase, predominately boosted by the health sector. In terms of traditional white collar employment sectors, growth over the year was only recorded in the finance, government and administration sectors; reflecting the modest tenant demand witnessed during the past year.

While employment growth in the finance & insurance and government sectors was soft in 2012-13, forward labour indicators are positive. Beyond 2014-15, a strong recovery is expected, driven by professional services. The diverse composition of Melbourne's white collar employment continues to insulate the CBD and other office markets, with the outlook for professional services remaining solid and forecast to continue to steadily boost employment in line with an improving economy over the next three years.

Reflecting the current tenant caution and focus on productivity gains, net absorption in the six months to July 2013 fell to negative 3,655m^2, in contrast to the past three and a half years of consecutive positive take up. Whilst the Melbourne CBD did record negative net absorption for the first half of 2013, it still outperformed all other Australian CBD office markets, which contracted at greater levels.

While overall net absorption was negative for the CBD as a whole, prime grade space significantly outperformed secondary grade space. As a result of the continued flight to quality by tenants, capitalising on the increased incentive levels, 72,562m^2 was absorbed in premium and A-grade office stock. In contrast, within secondary CBD office space, 76,217m^2 was vacated – the largest level recorded in 20 years.

Figure 2
Melbourne CBD Net Absorption
(000's m^2) per six month period



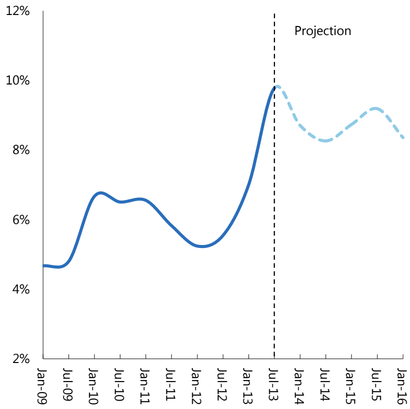
Source: PCA/Knight Frank

Looking forward, net absorption is forecast to improve, albeit still well below the historical average for the next 12 months. Melbourne's lower occupancy costs will continue to attract migrating tenants both within and outside the State. Net absorption over the next year is forecast to total 14,235m^2, boosted by a number of tenant relocations and CBD expansions including Bupa, Suncorp and Medibank. Without these incoming tenants, net absorption would likely be negative. Following the Federal election, with likely improving business confidence levels, leasing activity is expected to gather momentum during 2014.

Anticipated Vacancy Levels

Having risen to its highest level in nine years, total vacancy in the Melbourne CBD is forecast to have peaked. Aided by the migration of non-CBD tenants over the second half of 2013 and limited uncommitted new supply over the next year, total vacancy is forecast to trend down.

Figure 3
Melbourne CBD Vacancy
% total vacancy



Source: PCA/Knight Frank

While tenant demand is anticipated to remain subdued, white collar employment is forecast to continue to grow albeit modestly over the next 12 months, before accelerating late 2014.

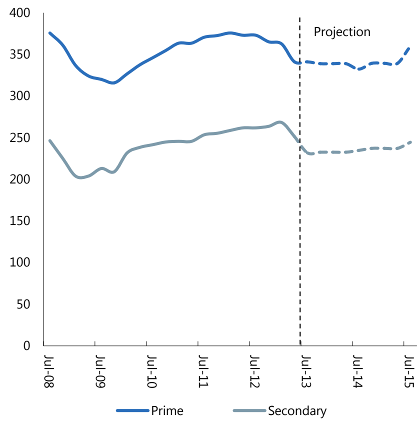
Rental Levels

Since the beginning of 2012, prime net face rents have largely remained steady; however tenant caution and increased backfill space have elevated incentive levels. Over the past six months, average incentive ranges have increased from 20%-25% to 25%-30%. As a result of increased incentive levels prime net effective rental levels have fallen by 5.9%. As at July 2013, prime net face rentals average $462/m^2. Illustrating the tenant flight to prime accommodation, secondary net effective rents have decreased 13.6%. As a result of the increased incentive levels coupled with a softening of face rental levels, average secondary net face rentals fell to $326/m^2.

In order to compete with the increasing leasing options through backfill and sublease, incentive levels for sitting tenants have also increased and typically range between 15% and 25%.

With tenants still cautious, face rental levels and incentive levels are forecast to remain steady over the next 12 months, before a steady reduction of incentive levels expected from late 2014.

Figure 4
Melbourne CBD Rents
$/m^2 average net effective rent



Source: Knight Frank

Table 3
Recent Leasing Activity (New Leases & Significant Renewals over 500m^2) Melbourne CBD

Address	Precinct	Estimated Net Face Rental ($/m^2)	Area (m^2)	Term (yrs)	Tenant	Start Date
80 Collins Street	Eastern	430	8,064	2	Australia Post	Q1-13
400 Queen Street	Flagstaff	240	2,000	5	Complex Training Academy	Q1-13
565 Bourke Street	Western	350	1,001	5	Department of Justice	Q1-13
121 King Street	Spencer	410g	2,100	6	Envato	Q2-13
35 Collins Street	Eastern	550	1,639	10	Salta Property	Q2-13
707 Collins Street	Docklands	400	1,074	n/a	Sladen Legal	Q2-13
600 Bourke Street	Western	420	580	3	Lloyds	Q3-13
55 Collins Street±	Eastern	375	997	7	GTA Consultants	Q3-13
120 Spencer Street	Spencer	360	3,500	10	Migration Review	Q3-13
1 Collins Street	Eastern	535g	554	5	Parliamentary Press Gallery	Q3-13
55 Collins Street	Eastern	450	1,034	10	JWS	Q3-13
357 Collins Street	Western	470	770	5	Infor	Q4-13
120 King Street	Western	395g	3,190	10	Aust. Institute of Music	Q4-13
600 Bourke Street	Western	450	1,200	10	Wotton & Kearney	Q4-13
55 Collins Street±	Eastern	420	2,070	10	RSM Bird Cameron	Q4-13
360 Collins Street	Western	500	1,232	10	Beddison Group	Q4-13
15 William Street	Western	290	617	5	IPP	Q4-13
567 Collins Street*	Western	450	4,400	10	Virgin Active	Q2-15

Source: Knight Frank * Pre-Lease deal ^ Lease Renewal g Gross Lease ± Sub-lease

INVESTMENT ACTIVITY & YIELDS

With AREITs having restructured their balance sheets, the increased capacity of unlisted funds and syndicates along with continued keen interest from domestic and offshore groups; investor appetite for quality assets remains robust.

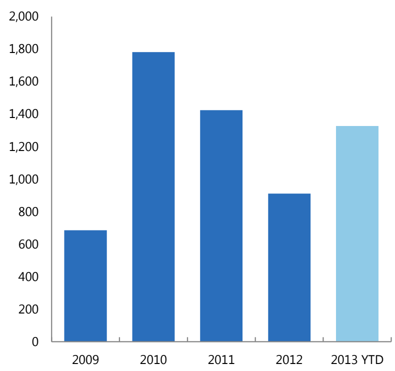
Investment sales activity (above $10 million) in 2013 year to date within the Melbourne CBD currently totals $1.32 billion across 16 properties. Transactions in 2013 to date have already surpassed sales achieved in the entire year of 2012, boosted by major forward-funding transactions.

In 2013 to date, unlisted trusts and syndicates have re-emerged to become the largest purchaser of CBD assets (on a gross basis) boosted by the increased allocation to real estate from institutional investors. Together, unlisted funds and syndicates acquired 40% of all purchases by value. Unlisted funds and syndicates' purchases included: Investa's Commercial Property Fund (567 Collins Street) and GPT's Wholesale Office Fund (8 Exhibition Street).

On a net basis, AREITs were the largest buyer of CBD assets and accounted for 30% of all sales. Increased flows into equities have resulted in AREITs becoming more aggressive purchasers through 2013.

Although at lower than levels than in the past two years, offshore groups remain keen investors, as demonstrated by the acquisition of 23% of all CBD transactions. Offshore groups seeing to diversify their investments remain focused on Australian office markets. Australian markets remain attractive to global investors drawn by Australia's transparent real estate market, stable economic environment, AAA rating and assets providing higher returns than many other developed countries.

Figure 5
Melbourne CBD Sales
($m) sales over $10 million



Source: Knight Frank

With development finance still challenging, developers were the most prominent vendors of Melbourne CBD office stock accounting for 34% of all sales in 2013 to date. Interestingly, divestments by super funds accounted for 33% of all transactions; however this was through three 50% stakes sold by Cbus Property in 8 Exhibition Street and 313 Spencer Street.

As a result of the imbalance between increased investor competition and limited investment opportunities, recent transactions have demonstrated evidence of yield compression. Major investors continued to focus on core assets with five transactions above $50 million. Prime buildings in core locations continue to be particularly sought after with prime quality assets accounting for 86% of sales volume transacted.

The increased investor appetite for Melbourne CBD office assets over the past 12 months, particularly for prime core properties, has widened the yield gap between prime and secondary yields. Recent transactions indicate that prime yields have compressed 10 basis points over the past 12 months to 6.90% and currently lie below their 10-year average. Given the level of investor interest and transactional evidence, further yield compression is likely through 2013 for prime assets. Secondary office yields have also compressed marginally to 8.35%, however the spread to prime yields remains above the 10-year average.

Table 4
Major Sales Transactions Melbourne CBD

Address	Price ($ mil)	Core Market Yield (%)	NLA (m^2)	$/$m^2$ NLA	WALE (Years)	Vendor	Purchaser	Sale Date
300 Flinders St	48.50	8.31^	14,093	3,441	7.0	Victoria University	Hotel Grand Central	Sep-13
399 Lonsdale St	31.50	10.06^	10,158	3,101	0.3	FKP Property Trust	Offshore Private Investor	Sep-13
380 Lonsdale St±	43.80	n/a	4,890	8,957	n/a	Offshore Private Investor	Hiap Hoe	Sep-13
168 Exhibition St	17.00	10.19^	6,298	2,699	1.0	State Trustees	Local Private Investor	Jul-13
8 Exhibition St^^	160.20	6.52^	44,929	7,131	4.4	Cbus Property	Keppel REIT	Jun-13
460 Bourke St	25.10	8.39	6,755	3,716	2.7	St Hilliers Enhanced Property	Offshore Private Investor	Jun-13
99 William St	28.50	7.50	6,988	4,079	3.2	Offshore Private Investor	PGA Group	May-13
90 Collins St	170.00	7.20	21,253	7,999	5.0	GE Real Estate	Mirvac	May-13
8 Exhibition St^^	160.05	6.50	44,034	7,269	4.7	Cbus Property	GPT Wholesale Office Fund	Mar-13

Source: Knight Frank ^ initial passing yield ^^ 50% interest * expected on completion passing initial yield
± bought for residential development

OUTLOOK

Impacted by the high Australian dollar, the Victorian economy is forecast to slow in 2013. However it is important to note that the economy is anticipated to continue to expand, albeit at a modest level of 1.6% according to Deloitte Access Economics. Forward indicators suggest that the outlook is brighter with predictions of economic growth of 2.4% in 2014 before increasing to 2.7% in 2015. Given Victoria's heavy reliance on the housing sector, lower borrowing costs should also result in boosting economic growth. In comparison to Australia's other capital cities, Melbourne's lower living costs will continue to support population growth which should aid the recovery.

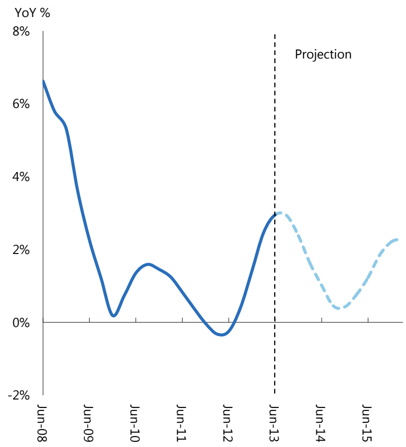
While Victoria has recorded relatively modest employment growth in the 12 months to May 2013 with 13,900 employees added to the workforce, key CBD office employment industries of finance and government grew, suggesting tentative signs of a stabilisation in the workforce.

Looking forward, white collar employment growth within the Melbourne CBD office market is expected to continue to gather momentum in the short term, in comparison to the contractions of 2012. Deloitte Access Economics is forecasting white collar employment growth of 0.8% in 2014, increasing to 1.5% in 2015 and 2.0% in 2016.

Whilst leasing activity in the CBD is expected to remain patchy over 2013, net absorption levels in the short term are anticipated to remain positive, aided by new tenants migrating in to the CBD. Net absorption levels are forecast to improve markedly in late 2014 in line with increasing white collar employment growth which is anticipated to be led by professional services, finance and government sectors.

In contrast to the past five years, new supply within the CBD is constrained in the medium term, particularly over the next 12 months, which should underpin a steady decline of vacancy levels. However the impending magnitude of lease expiries in 2016 suggest that further developments may be announced, in addition to the pipeline of projects already under construction.

Figure 6
White Collar Employment Growth
Melbourne CBD



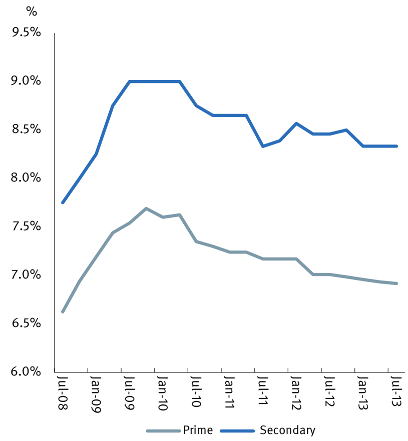
Source: Deloitte Access Economics

MELBOURNE'S LOWER OCCUPANCY COST WILL REMAIN AN ATTRACTIVE PROPOSITION TO TENANTS

Despite the anticipated patchy recovery of tenant demand, Melbourne CBD's cost competitiveness will remain an attractive proposition to tenants seeking to relocate to and expand offices, providing growth in occupied stock. While net absorption is forecast to remain positive over the next two years, absorption levels will be driven by these migrating tenants in contrast to organic growth from sitting tenants.

Total vacancy is expected to gradually trend lower from its current peak of 9.8%, assisted by the limited un-committed pipeline of new supply. Sublease vacancy levels are also showing signs of stabilisation, which will likely maintain sublease levels below the peaks recorded in the previous downturns of 2009 and 2003.

Figure 7
Melbourne CBD Average Yields
Prime and Secondary Core Market Yields



Source: Knight Frank

Prime face rental rates are forecast to remain steady along with the heightened level of incentives for new tenants over the next 12 months. Given the increasing tenants' preference to upgrade their office accommodation, capitalising on market conditions, secondary face rentals may soften further.

In contrast to the subdued leasing activity, the increased level of investment competition is likely to maintain downward pressure on yields, particularly for prime core assets. As threats to the global economy continue to recede, investors have sought to increase their exposure to commercial property in contrast to a lower returning asset class. Moreover the availability of funds from unlisted funds, superannuation groups and AREITs, in comparison to the limited investment opportunities, is likely to result in investors moving up the risk curve, which should lead to secondary yield compression, albeit to a lesser degree.

RESEARCH

Americas
USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia
Australia
New Zealand

Europe
UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
The Netherlands
Ukraine

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

The Gulf
Bahrain
Abu Dhabi, UAE

Knight Frank Research

Richard Jenkins
Director – Research Victoria
+61 3 9604 4713
richard.jenkins@au.knightfrank.com

Matt Whitby
National Director – Head of Research & Consulting
+61 2 9036 6616
matt.whitby@au.knightfrank.com

Commercial Agency Contacts – Sales

Paul Henley
Managing Director – Commercial Sales & Leasing
+61 3 9604 4760
paul.henley@au.knightfrank.com

Stephen Imrie
Director – Capital Markets
+61 3 9604 4634
stephen.Imrie@au.knightfrank.com

Langton McHarg
Director – Commercial Sales
+61 3 9604 4619
langton.mcharg@au.knightfrank.com

Marcus Quinn
Director – Commercial Sales
+61 3 9604 4638
marcus.quinn@au.knightfrank.com

James Templeton
Managing Director – Victoria
+61 3 9604 4724
james.templeton@au.knightfrank.com

Commercial Agency Contacts – Leasing

Hamish Sutherland
National Director – Office Leasing
+61 3 9604 4734
hamish.sutherland@au.knightfrank.com

Michael Nunan
Director – CBD Leasing
+61 3 9604 4681
michael.nunan@au.knightfrank.com

Ben Ward
Director – CBD Leasing
+61 3 9604 4677
ben.ward@au.knightfrank.com

James Pappas
Director – CBD Leasing
+61 3 9604 4635
james.pappas@au.knightfrank.com

Terry Dohnt
Director – Corporate Leasing
+61 3 9604 4702
terry.dohnt@au.knightfrank.com

Valuation Contacts

Joe Perillo
Joint Managing Director – Victoria
+61 3 9604 4617
joe.perillo@vic.knightfrankval.com.au

Michael Schuh
Director
+61 3 9604 4726
michael.schuh@vic.knightfrankval.com.au

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, financial and corporate institutions. All recognise the need for the provision of expert independent advice customised to their specific needs.

Knight Frank Research reports are also available at KnightFrank.com.au.